

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

VALASSIS NSA	)	Docket No. MC2012-14
	)	
VALASSIS NSA	)	Docket No. R2012-8

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.  
REPLY COMMENTS**  
(June 1, 2012)

William J. Olson  
Herbert W. Titus  
John S. Miles  
Jeremiah L. Morgan  
WILLIAM J. OLSON, P.C.  
370 Maple Avenue West, Suite 4  
Vienna, Virginia 22180-5615  
(703) 356-5070

Counsel for:  
Valpak Direct Marketing Systems, Inc. and  
Valpak Dealers' Association, Inc.

**TABLE OF CONTENTS**

I.	NAA, NNA, the PR, and Other Commenters Demonstrate that the Valassis NSA Likely Will Result in a Net Revenue Loss, Not a Net Revenue Gain. . . . .	1
II.	NNA Demonstrates the Failure of the Valassis NSA to Comport with Requirements of 39 U.S.C. § 404a. . . . .	5
III.	The Public Representative and NAA Helpfully Explain the Newspaper Industry Model, but Do Not Offer a Theoretical Economic Analysis of the Flaws in the Valassis NSA. . . . .	7
IV.	The PR’S Comments Properly Question the Postal Service’s Ability to Ensure Compliance with the NSA and Reporting based on the NSA. . . . .	11
V.	Landmark Media Enterprise’s and NNA’s Comments Highlight the Importance of Not Putting the Mailbox and Mailbox Monopoly at Risk.. . . .	13
VI.	The Postal Service Strenuously Should Avoid Entering into any NSA that Artificially Creates One Mailer which Is Too Big to Fail. . . . .	14
VII.	NNA’s Contention that ECSI Value Bears on this Decision Is Not Well Founded. . . . .	17
VIII.	The Initial Comments of William C. Miller Fail to Demonstrate that the Valassis NSA Conforms to Law. . . . .	18
	CONCLUSION.. . . .	20

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Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.  
(hereinafter "Valpak") hereby file their Reply Comments regarding the Proposed Market  
Dominant Negotiated Service Agreement ("NSA") between the U.S. Postal Service and Valassis  
Direct Mail, Inc. ("Valassis").

These Reply Comments primarily address: (i) the "Opposition of the Newspaper  
Association of America" ("NAA Comments"); (ii) the "Comments of National Newspaper  
Association, Inc." ("NNA Comments"); (iii) the "Comments of the Public Representative"  
("PR Comments"); and (iv) the "Comments of William C. Miller" ("Miller Comments").

**I. NAA, NNA, the PR, and Other Commenters Demonstrate that the Valassis  
NSA Likely Will Result in a Net Revenue Loss, Not a Net Revenue Gain.**

One of the most significant statutory hurdles for an NSA is the requirement that the  
Postal Service establish that it will "improve the net financial position of the Postal Service...."  
39 U.S.C. § 3622(c)(10)(A)(i). Although Valpak's Initial Comments addressed the Postal  
Service's failure to present data demonstrating that this criterion is met<sup>1</sup> (Valpak Initial

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<sup>1</sup> See also NAA's Comments, which begin by establishing that the Postal Service  
failed to demonstrate a net financial gain:

Under Section 3622(c)(10)(A)(i) and Commission rule 39 C.F.R. §3010(b)(3),

Comments, p. 10), Valpak was not in a position to offer hard information about the magnitude of revenue losses the Postal Service would be likely to incur. However, other commenters, who have information about the newspaper industry available to them, have now shared it with the Commission.

NAA presented information on trends for total market coverage (“TMC”) mail, the type of mail which the Valassis NSA could be expected to cannibalize, and which usually is sent at the full rate for Saturation and High-Density mail. NAA had commissioned a study by Mather Economics which shows that “TMC postage appears stabilized around \$500 million today.” *Id.*, p. 24. However, “[b]ased on what members are telling NAA, **at least \$200 million annually** of this mail could leave the postal system if the Valassis NSA takes effect. Over the three years of the NSA, this would total **some \$600 million**, dwarfing the \$107 million in ‘new’ revenue the Postal Service hopes to receive from Valassis.” *Id.* (emphasis added). NAA’s

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the Postal Service must show that an NSA will result in a net financial benefit to the Postal Service. It has not done so, and it has **not even presented the proper information**. That alone means that the NSA cannot be found legally compliant. Moreover, the NSA is **far more likely** to result in a **net financial loss** to the Postal Service, as it is likely to drive away as much as six times as much TMC postage revenue, and corresponding contribution, as it stands to gain from Valassis. [NAA Comments, p. 18 (emphasis added).]

NAA explained that the Postal Service discussion of the net financial impact of the Valassis NSA addressed only the impact of the increased Valassis volume, but not: potential postage losses *from other mailers* as a consequence of the Postal Service favoring one mailer with the NSA.... Here, the Postal Service has *completely* failed to consider postage losses from other mailers.... This failure to comply with the Commission’s rules alone is sufficient grounds for holding the NSA to be not in compliance with law. [*Id.*, p. 20 (italics original).]

Initial Comments appear consistent with comments filed by many newspapers, and Senator Charles Schumer's (D-NY) comments herein also relied on NAA's estimates.

Similarly, NNA confirmed that the Valassis NSA threatens many of its members, resulting in those newspapers removing mail from the Postal Service:

the Postal Service has ignored the fact that many, many newspapers TMCs and shoppers are in the Standard High-Density mail stream now.... So the NSA that that [sic] pulls the advertising piece out of the newspaper High Density-rated TMC product and into any Saturation product — not to mention a steeply-discounted one — is the most destructive one for the Postal Service's bottom line. This NSA trades a minimum \$27 per 1,000 or higher in USPS revenue for a lower net revenue from an identical product.... The possibility that USPS is leaving money on the table has haunted NSAs from their beginnings. [NNA Initial Comments, pp. 10-11.<sup>2</sup>]

The PR also was cognizant of the likely impact of the NSA on mail volume from newspapers. After explaining the structure of the circular market and the respective roles Valassis and the newspapers currently play in it (PR Initial Comments, pp. 4-5), the PR analyzed the net financial effect of the NSA. "Because of the unequal profitability of these pieces before [*i.e.*, highly profitable High Density] and after [*i.e.*, heavily discounted Saturation] they are captured by Valassis, a point will come early on at which the volume success of the Valassis NSA carries within it the seeds of net revenue failure." *Id.*, p. 8.

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<sup>2</sup> NNA concluded that the Postal Service should consider more broadly applicable, less discriminatory pricing: "An across-the-board classification that serves both large and small customers is the easiest to administer, the most durable and the least likely to encourage migration from one part of the mail stream to another with a net loss to the Service. If the Service hasn't already thought of that, the Commission should invite it to do so." *Id.* This appears consistent with Valpak's support for lower rates for all high coverage mailers. See Valpak Initial Comments, p. 29.

Furthermore, “Due to this disparity in contribution, Valassis would have to generate 2.55 new Saturation pieces for every 1 High Density Flat that is lost.” *Id.*, p. 9 (emphasis original).

Additionally, the PR pointed out that “[a]nother, even more serious potential source of net contribution leakage associated with this NSA is the **diversion of solo advertising mailings** by national brand department and home improvement stores into heavily discounted NSA mailings.” *Id.*, p. 11 (emphasis added). Although terms of the Valassis NSA purport to protect against diversion of Valassis’ solo mail volume to the contract volume, there is no protection against diversion from **other mailers’** solo mailings, and no party has attempted to estimate the lost revenue from these other solo mailings if they were to convert to one of Valassis’ shared mailings.

The Postal Service’s history with NSAs demonstrates that its projections cannot be trusted. *See, e.g.*, Valpak Initial Comments p. 25 (discussing Bank of America NSA). And the comments filed in this docket demonstrate that the Postal Service appears oblivious to the downside of this NSA.

Lastly, the comments of NAA, NNA, and various newspapers demonstrate Congress’ wisdom in requiring that the Governors explicitly review and approve terms of each NSA in advance, before submission to the Commission. Failure to follow that statutory plan by having the benefit of nine outside Governors reviewing and approving the NSA before it was filed has in no small part contributed to the almost unanimous opposition that this proposal has engendered. *See* Valpak Initial Comments, Section I. As stated there, the Commission should return this NSA to the Governors forthwith, not for reconsideration — as they never considered

it — but for an initial review. Based on the widespread opposition this NSA has generated, the Governors may well appreciate the opportunity to end this NSA before it begins.

## II. NNA Demonstrates the Failure of the Valassis NSA to Comport with Requirements of 39 U.S.C. § 404a.

NNA presented important information concerning the applicability of 39 U.S.C. section 404a not addressed by Valpak in its Initial Comments.<sup>3</sup> NNA describes this section, which was written into law as part of the Postal Accountability and Enhancement Act of 2006 (“PAEA”), as “the Postal Service[’s] own restraint of trade statute.” NNA Initial Comments, p. 5. NNA further describes this provision being enacted in reaction to the U.S. Supreme Court’s decision in U.S. Postal Service v. Flamingo Industries, Ltd., et al., 540 U.S. 736 (2004), which just two years earlier had established “that the Postal Service could engage in predatory behavior without its competitors having recourse to the courts” under the Sherman Act.<sup>4</sup> *Id.*

39 U.S.C. section 404a is entitled “Specific Limitations” and reads:

- (a) Except as specifically authorized by law, the Postal Service may not—
  - (1) establish any rule or regulation (including any standard) the effect of which is to **preclude competition** or establish the terms of competition **unless the Postal Service demonstrates** that the regulation does **not create an unfair competitive advantage** for

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<sup>3</sup> Valpak’s Initial Comments focused on evaluating the Valassis NSA against the standards established in 39 U.S.C. § 3642(b)(3) (relating to new products) and 39 U.S.C. § 3622(c)(10) (relating to special classifications), and the Commission’s corresponding regulations in 39 C.F.R. §§ 3010.32 and 3010.42. *See* Valpak Initial Comments, pp. 7-11, 18-26. Valpak also addressed 39 U.S.C. § 403(c) as one of the policies of Title 39 which are incorporated into 39 U.S.C. § 3622(c)(10). *See id.*, p. 21.

<sup>4</sup> *See also*, 39 U.S.C. § 409(e)(1).

itself or any entity funded (in whole or in part) by the Postal Service.... [39 U.S.C. section 404a (emphasis added).]

NNA's Initial Comments accurately describe this statute as establishing that the "burden is on the Postal Service to demonstrate that its actions do not create an unfair competitive advantage" and the Court relied "upon the Commission's role in protecting against anti-competitive behavior by USPS...." NNA Comments, p. 5 (underscore original). Thus, it is not the responsibility of commenters to prove that the Valassis NSA will create an unfair competitive advantage, but upon the Postal Service to demonstrate it will not. Congress placed the burden on the Postal Service to demonstrate that these standards are met, and Congress simultaneously placed the burden on the Commission to evaluate whether the Postal Service has met its burden, which it has not. The Postal Service's initial filing was devoid of meaningful analysis of the competitive effect of the NSA. *See* Valpak Initial Comments, p. 18. Further, it declined to provide meaningful information in response to Chairman's Information Requests. *See id.*, p. 19.

The only avenue of escape from this pricing obligation would be for an affirmative demonstration by the Postal Service that it is "specifically authorized by law" under subsection (a) to enter into the Valassis NSA. The "except" clause was not addressed by NNA. There are two provisions granting the Postal Service relevant powers. Although 39 U.S.C. section 401(3) confers upon the Postal Service the general power "to enter into and perform contracts," that power is expressly made "[s]ubject to the provisions of section 404a." In like manner, the specific power conferred upon the Postal Service by 39 U.S.C. section 404(a)(2) "to prescribe ... the amount of postage and the manner in which it is to be paid," is also "[s]ubject to the



provisions of 404a.” Section 404a, then, serves as a more exacting limit on the Postal Service’s pricing flexibility in conformity with its general duty under 39 U.S.C. section 403(a) to “plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees.”

The Postal Service’s routine invocation of its “pricing flexibility” under 39 U.S.C. sections 3622(b)(4) and 3622(c)(7) only takes it so far. The Postal Service has no pricing flexibility whatsoever to establish prices in violation of Title 39. If the Commission were to approve this NSA routinely, as it has approved all prior NSAs,<sup>5</sup> despite serious issues that have been raised by various parties, the Commission would forfeit its separateness from the Postal Service in favor of deference to the Postal Service, and would abandon its role in ensuring that Postal Service pricing decisions are made in accordance with the policies of Title 39.

### **III. The Public Representative and NAA Helpfully Explain the Newspaper Industry Model, but Do Not Offer a Theoretical Economic Analysis of the Flaws in the Valassis NSA.**

The PR’s Comments, citing 39 U.S.C. section 404a, persuasively describe the “unfair competitive advantage” for Valassis over all of its competitors, including the newspaper industry, created by this proposed NSA:

The Postal Service has not provided a plausible rationale for excluding these direct marketing companies from the market niche that the Valassis NSA would protect. In terms of section 404a(a)(1) of the PAEA, the **discriminatory price structure** that it erects “precludes competition” and constitutes an “unfair

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<sup>5</sup> Of course, the Washington Mutual Bank NSA (Docket No. MC2006-3) was withdrawn by the Postal Service prior to a Commission decision.

competitive advantage” which the Postal Service is attempting to secure for itself vis a vis the **newspaper industry**, setting up Valassis as its proxy for capturing the Sunday circular market. [PR Comments, p. 7 (emphasis added).]

The PR provides important background information concerning the effect of the NSA on the newspaper industry. PR Comments, pp. 3-5, 11-12. Likewise, NNA’s Comments (pp. 6-11) and NAA’s Comments (pp. 3-9) relating to the same topic are informative and helpful. NAA cites to the Commission’s response to witness John Panzar’s testimony in Docket No. MC2002-2, but does not explain how Panzar’s analysis based on fundamental economic principles applies to this type of NSA. NAA Comments, p. 12 .

Prices established in the Valassis NSA provide a straightforward example of an **optional tariff offering**. In Docket No. MC2002-2, John Panzar, testifying as a Commission witness, discussed in some detail agreements that contain such an optional tariff offering. Part of that testimony is highly pertinent here:

in the case of postal services, volume discounts [or optional tariff offerings] are likely to be offered to business users [*e.g.*, Valassis]. For these mailers, postal services are used as an *input* in the provision of other products [*e.g.*, advertising inserts, either in wraps or in newspapers] and services to other businesses and final consumers. **This complicates the analysis considerably.**

First, the input demand curves of firms that compete in the final product markets [*e.g.*, Valassis and newspapers] **are necessarily interdependent**. This **interdependence** causes the breakdown of the elegant Pareto improvement argument in support of optional tariff offerings. Indeed, **one cannot even presume that the introduction of optional tariff offerings will increase total surplus in the market**. Thus, assessing the desirability of optional tariff offerings requires the detailed analysis of (forecasted) demands and costs typical of rate proceedings. [Docket No. MC2002-2, Testimony of John Panzar, p. 14 (emphasis added; footnote omitted).]

Aside from the last sentence in witness Panzar's statement, *supra*, about an optional tariff offering (such as the Valassis NSA) requiring "detailed analysis of (forecasted) demands and costs," Panzar's analysis is presented in general economic terms applicable to any industry characterized by a dominant monopolist. Witness Panzar's testimony then applied those general principles to the market for postal services, noting that the difference between demand functions that are **independent** versus those that are **interdependent** is critical to conclusions that can be drawn with respect to competitors of the firm being affected by the optional tariff offering. The bracketed inserts below seek to show the application of principles in the Panzar testimony to the current NSA.

This standard assumption [of demand **independence**] is quite reasonable when the service in question is being sold to final consumers or as an input to firms operating in different final product markets. If the large user is a credit card vendor such as Capital One, there is no reason to expect that, if it makes use of a quantity discount, there will be any effect on the demand curves for mail of other users that are individual consumers or small firms in, say, the floral industry. [When demand is **interdependent**] [h]owever, **things are very different for Capital One's [Valassis'] competitors [e.g., newspapers]. Their demand curves for mail services depend very much on the mailing options available to Capital One [Valassis]. This interdependence** is a result of the economics of price determination in multi-firm markets. [*Id.*, p 15 (emphasis added).]

Witness Panzar then discussed certain details concerning the applicable economic analysis when an optimal tariff offering is introduced into a market where demand functions are **interdependent**, concluding that:

In the new market equilibrium: (1) the market price of output falls; (2) the output of the **favored firm** increases; and (3) the

output, input purchases, and profits of **firms not receiving the discount decrease**. [*Id.*, p. 16 (emphasis added).<sup>6</sup>]

Although witness Panzar's testimony about NSAs was presented in 2003,<sup>7</sup> that testimony anticipates and confirms what NAA, NNA, the PR, and others have commented in this docket regarding the newspaper insert business. Namely, as a result of the optional tariff offering contained in the Valassis NSA: (i) the market price for delivering advertising inserts in newspapers or via the mail predictably will fall; (ii) output of the favored firm, Valassis, will increase; and (iii) profits of firms not receiving the discount (*e.g.*, newspapers) will decrease.

Witness Panzar's testimony explains the economic effect of such results.

This network of **feedback interactions** has **profound implications** for the evaluation of optional tariff offerings. Recall that, when user demands are independent, any optional tariff offering voluntarily agreed to by a user and a profit seeking monopolist can be *presumed* to be efficient because it can make possible a Pareto improvement. **No such presumption is possible when there are downstream competitors** [*e.g.*, the newspapers or Vertis which filed comments] **of the favored user** [Valassis]. The elegant, simple argument of the previous section **breaks down** because the **output expansion of the favored user** [Valassis] **will be** (to some extent) **offset by an output contraction of users** [*e.g.*, newspapers] that do not [or can not] avail themselves of the discount. A **foresighted monopolist** would of course take such **feedback effects** into account when designing an optional tariff offering, ... However, the negative effect on small users will remain, *even if the established tariff remains available*. [*Id.*, pp. 16-17 (italics original; footnote omitted; emphasis added).]

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<sup>6</sup> To a great extent, the language of PAEA's 39 U.S.C. section 404a can be seen as a statutory embodiment of these economic principles.

<sup>7</sup> Professor Panzar discussed these aspects of Postal Service pricing more recently in a report in December 2009 commissioned by the Postal Service Office of the Inspector General: "Postal Service Pricing Policies after PAEA," pp. 18-26, [http://www.uspsoig.gov/foia\\_files/RARC-WP-10-002.pdf](http://www.uspsoig.gov/foia_files/RARC-WP-10-002.pdf).

As pointed out by the Comments of NNA and the PR (as well as several other commenters), the Postal Service's analysis has made virtually no effort to take feedback effects into account. 39 U.S.C. section 404a therefore makes it incumbent on the Commission's evaluation to give full consideration to the effect of the Valassis NSA on competition, including possible feedback effects (with no input from any of the Postal Service's submissions, unfortunately). Furthermore, as comments by NNA and the PR (and others) state, the feedback effect from newspapers (the "other users" and "downstream competitors" referred to in Panzar's testimony) will be predictably negative, even though the established tariffs for High-Density and Saturation mailings which they use remain available. Any such negative effect on other users, especially if that effect is large, clearly is anti-competitive and also must be weighed in the Commission's evaluation of this NSA. *See* Section I, *supra*, for discussion concerning quantitative estimates of feedback effect.

#### **IV. The PR'S Comments Properly Question the Postal Service's Ability to Ensure Compliance with the NSA and Reporting based on the NSA.**

The PR questioned the ability of the Postal Service to assure compliance with the conditions of the NSA by Valassis (and its advertisers): "Given a lack of publicly available information, how will the Postal Service measure compliance with the contract terms?" PR Initial Comments, p. 16. The PR astutely points out that compliance with the contract relies on information in the possession of third parties — the advertising retailers — information to which the Postal Service and Valassis might not have access. Valpak concurs with the PR's conclusion

that “Without strong standards and easily reportable metrics, it will be nearly impossible for the Postal Service or Valassis to determine if a retailer qualifies for participation.” *Id.*

The problem could even be greater than the PR anticipates. PAEA requires the Postal Service to comply with several aspects of the 2002 Sarbanes-Oxley law as well as the Securities Exchange Act. *See* 39 U.S.C. § 3654. The inability of the Postal Service to be able to confirm that mailings under this agreement comply fully with the complicated conditions therein will make it difficult, if not impossible, for the Postal Service to comply with section 3654, particularly the annual certification regarding its internal controls over financial reporting. *See* 39 U.S.C. § 3654(a)(3).

The Postal Service represents that Valassis will have sufficient incentive to ensure compliance with the contract. *See* Response to ChIR No. 1, Question 6. But those assurances are inadequate. Even the contract itself is vague: “Procedures for auditing compliance with the terms and conditions described in this agreement will be established by the Postal Service after consulting with Valassis.” *See* Notice, Attachment B, p. 5, Para. VI.A.4. As the PR discussed: “Even acting in good faith, Valassis may not be able to gather information sufficient to ensure compliance with the contract language for specific companies.” PR Initial Comments, p. 17.

Additionally, under section 3564(e), the Commission also has responsibilities to assure the “quality, accuracy, [and] completeness of Postal Service data.” For the reasons stated above, the Valassis NSA likely will jeopardize the Commission’s ability to fulfill its responsibilities under the law.

**V. Landmark Media Enterprise’s and NNA’s Comments Highlight the Importance of Not Putting the Mailbox and Mailbox Monopoly at Risk.**

Landmark Media Enterprise, LLC submitted comments which illustrate the competitive importance of the mailbox, and therefore the mailbox monopoly: “The Valassis NSA filing, if approved, pressures us to stay out of the mail to help assure our competitiveness for ad inserts, despite the obvious attraction of being in the **mailbox**.” Landmark Comments, p. 1 (emphasis added). Similarly, NNA argues that the Postal Service is “under pressure to shed its government skin and try to act like a private player in the markets even while holding onto the **mailbox** and the mail **monopoly**.” NNA Comments, p. 14 (emphasis added).

Valpak believes that it would be wise for the Commission to consider the importance of the mailbox monopoly, and whether the mailbox monopoly was designed to enable the Postal Service to favor certain mailers as this NSA favors Valassis.<sup>8</sup> One of the great impediments to alternative delivery is not the monopoly over letter mail, but the monopoly over the mailbox. *See, e.g.*, GAO Report, U.S. Postal Service: Information About Restrictions on Mailbox Access (May 1997) (GAO/GGD-97-85), pp. 10, 14, 24, 34, 54. If the mailbox monopoly appears abused, in a dynamic environment of Congressional reform, it is not impossible to see its elimination. Indeed, efforts to do so are already underway. During consideration of postal reform legislation earlier this year, an amendment was offered first in the Senate Committee on Homeland Security, and later on the Senate floor, to remove the Postal Service’s monopoly over

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<sup>8</sup> Should the Commission agree with Valpak that this NSA is not properly before the Commission, not having been properly approved by the Governors (*see* Valpak Initial Comments, pp. 3-6), the Governors also would have the opportunity to evaluate whether the Valassis NSA is worth risking what is perhaps the most important part of its statutory monopoly.

the mailbox. Introduced by Senator Rand Paul (R-KY), Amendment 2025 was defeated by a vote of 64-35 on April 24, 2012.<sup>9</sup> Should the Postal Service be perceived by Congress as abusing its monopoly powers, additional Senators may decide that the Postal Service no longer deserves a monopoly over the mailbox.

**VI. The Postal Service Strenuously Should Avoid Entering into any NSA that Artificially Creates One Mailer which Is Too Big to Fail.**

Although one might assume that the Postal Service designs each NSA with the intent of benefitting itself financially, the Postal Service's failure to analyze revenue losses it could suffer as a result of this NSA (*see* Section I, *supra*) gives rise to the appearance of an NSA designed to serve the financial interests of Valassis more than those of the Postal Service. Although this may seem an extreme conclusion, it is fully consistent with comments by others.

NAA's Comments begin with the statement "The NSA is intended to serve the special interest of one direct mailer — Valassis...." NAA Comments, p. 1. It describes the NSA as the Postal Service "partnering with a single large advertising mailer...." *Id.*, p. 2. "NSA's criteria governing mailer eligibility describes Valassis in all but name...." *Id.* p. 5.

NNA states "The Service's intention ... is geared toward a special deal with one large and historically favored customer." NNA Comments, p. 3.

Several newspapers also pointed out the solitary nature of the Valassis NSA:

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<sup>9</sup> [http://www.senate.gov/legislative/LIS/roll\\_call\\_lists/roll\\_call\\_vote\\_cfm.cfm?congress=112&session=2&vote=00076](http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=112&session=2&vote=00076).



- The Antelope Valley Press, states, “We urge the USPS, which holds the monopoly on mail delivery not to use that power in a way that favors a single special customer, acting essentially as a special interest that because of its favored position is acting as a destructive force....”
- Advance Publications, Inc., states “Reductions in [free-standing inserts] revenue caused by an NSA specifically designed to unfairly benefit Valassis, at the expense of newspapers and the communities they represent and support across the county, does not further the public good....” P. 2.
- The Washington Post states “The Post is dismayed that the Postal Service would seek approval of an NSA that on its face favors only one mailer....”
- The Miami Herald states “The current proposal will not only do real financial harm and wreak havoc in the marketplace by giving an extremely one-sided, unfair competitive advantage to Valassis, but at the same time, will do nothing to improve the Postal Service’s bottom line.”
- The Milwaukee Journal Sentinel states “the proposed NSA has been created in a way that advantages one mailer and one mailer only.” P. 2.

The Public Representative states that under this NSA “Valassis would ... be in a financial position to outbid any deal that the newspapers could counter with. Such a scenario would be an example of predatory pricing in its purest form — made possible by leveraging the Postal Service’s monopoly power, and lethal to newspapers. The Postal Service has offered no

rationale whatever to justify a discount structure that gives the green light to this kind of market predation.” PR Comments, p. 18.<sup>10</sup>

Since the Great Recession of 2008-2009, problems presented by financial institutions considered “too big to fail” have received significant attention. Increasingly, it is understood that a regulatory scheme which leads to consolidation of smaller competitors and their concentration into a few large corporations is generally not desirable. When firms become “too big to fail” and then suffer reverses, almost invariably they seek bailouts from taxpayers, or other special treatment from government. Additionally, when such firms reach a certain size, they can exercise undue influence over companies from which they buy.<sup>11</sup> It is one thing if consolidation is the result of good management combined with economies of scale and scope, but quite another if it is the result of nothing more than preferential treatment from the government.

Valassis’ current annual mail volume is believed to be in the range of 3 to 4 billion pieces — more than one third of all Saturation flat volume.<sup>12</sup> It is beyond dispute that this NSA was designed to meet the needs of a single for-profit company, and that it could be expected to make that company still larger and more profitable, while the Postal Service winds up losing

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<sup>10</sup> Another newspaper publisher suggested the Valassis NSA be viewed in the context of the recently implemented EDDM-R: “Add this Valassis proposal USPS’ existing attempts to get postmasters to sell direct mail to local newspaper advertisers, and you have a pretty negative business relationship.” Cadillac News Comments.

<sup>11</sup> See, e.g., [http://www.barrypopik.com/index.php/new\\_york\\_city/entry/if\\_you\\_owe\\_a\\_bank\\_thousands\\_you\\_have\\_a\\_problem\\_if\\_you\\_owe\\_a\\_bank\\_millions\\_t/](http://www.barrypopik.com/index.php/new_york_city/entry/if_you_owe_a_bank_thousands_you_have_a_problem_if_you_owe_a_bank_millions_t/).

<sup>12</sup> Postal Service Notice, p. 4.

money when the NSA drives away other, far more profitable business. If Valassis can negotiate this type of discriminatory and preferential price with its current volume and market share, one can only imagine what it might negotiate in the future.

The banking industry has an old saying: “If you owe the bank \$100, that’s your problem, but if you owe the bank \$100 million, then it’s the bank’s problem.” With this NSA, it might be said that if you mail only a few pieces, you should be thankful if the Postal Service simply delivers your mail, but if you are the Postal Service’s largest customer, you can get the Postal Service to tilt the playing field to help you grow even bigger at the expense of your competitors. Then, after reaching a critical volume, you can threaten to set up your own private delivery company and divert all that Saturation mail from the Postal Service in one fell swoop. This would appear to be a predictable scenario, since the Postal Service claims private delivery companies with volume far smaller than Valassis’ already are successfully siphoning off Saturation mail. *See* Postal Service Notice, p. 3 and Attachment E, p. 4-5. At that point, the Postal Service no doubt will wonder how it managed to get itself into a position where one mailer could realistically threaten to take away so much of its most profitable business.

## **VII. NNA’s Contention that ECSI Value Bears on this Decision Is Not Well Founded.**

Although Valpak agrees with the thrust of NNA’s comments against the Valassis NSA, it decidedly does not agree that ECSI considerations under 39 U.S.C. section 3622(c)(11) require the Valassis NSA to be turned down. *See* NNA Comments, p. 12. That provision establishes a factor that the Commission consider “the educational, cultural, scientific, and informational value to the **recipient** of mail matter....” (Emphasis added.) Historically, the principal

application of this factor has been to support giving Periodicals a lower than average coverage than otherwise would be required of the class because of their editorial content being of value to recipients. Valpak sees no support for the position that ECSI considerations require that all Commission decisions favor periodicals mailers. Valpak urges the Commission to turn down the Valassis NSA, but not for this reason.

### **VIII. The Initial Comments of William C. Miller Fail to Demonstrate that the Valassis NSA Conforms to Law.**

The only Initial Comments supporting the Valassis NSA were submitted by William C. Miller. Miller summarized his view of NSAs in general, and this NSA in particular, as follows:

Market dominant NSAs have been used **in the past** by the Postal Service as a device to expand markets, generate incremental volume with a **consequential result which is beneficial to the Postal Service** and the mailer under contract. The current NSA is no exception ... Based on the incremental contribution estimated [and] submitted by the Postal Service, It [sic] appears that the proposed NSA will be beneficial to the Postal Service and Valassis. Therefore the NSA should be approved by the Commission. [*Id.*, pp. 7-8 (emphasis added).]

Miller seems unaware that, to date, the cumulative result of market dominant NSAs under PAEA has been anything but beneficial, costing the Postal Service many millions of dollars. See Valpak Initial Comments, pp. 13-15.

Furthermore, Miller erroneously assesses the Valassis NSA in two significant respects.

First, he addresses the issue of volume diversion:

A **key factor** in the Postal Service's estimate is the preservation of the existing contribution by **assuming zero mail migration from the existing programs** to the new discount eligible program ... Since the added contribution depends crucially on zero or minimal

mail migration, the agreement includes several compliance related provisions intended to insulate the program from any contribution reducing volume diversion. However all details with respect to Valassis compliance with mail eligibility requirements have not been fully delineated. [Miller Comments, pp. 2-3 (emphasis added).]

Miller expresses various concerns about possible diversion by Valassis of existing volume, and the ability of the monitoring system to detect such diversion. But his concerns focus myopically on, and are limited to, (i) any weight reduction that does not affect existing mail volume appreciably, and (ii) switching non-eligible piece mailings to price-discounted mailings without affecting piece weight appreciably. *Id.*, p. 4. His concerns about diversion are quite legitimate, but Miller misses entirely the diversion of High-Density mailings by newspapers as a direct result of the Valassis NSA. *See, e.g.*, Section I, *infra*. Potential losses on account of diversion by newspapers greatly exceed any losses that might arise from diversion by Valassis.

Second, Miller also discusses rates that will be paid by Valassis following termination of the contract after three years:

The proposed NSA is largely silent on what happens to the two tier pricing system for Valassis mail at the end of the agreement in three years. However language in the agreement suggests the return to a uniform pricing system for all Valassis saturation mail **at a yet undetermined rate level**. [*Id.*, p. 6 (emphasis added).]

After quoting two sentences in the agreement, Miller makes a rather heroic leap and infers that:

the distinction between the new and existing mail programs is dissolved with contract termination and that **Valassis would be eligible to pay discounted rates for mail now delivered under its existing mail program**, unless the discounted rates were negotiated to some new level. [*Id.* (emphasis added).]

The NSA contains no language pertaining to rates charged following termination — other than those contained in the general tariff structure for Standard Mail, of course. Miller cites no predicate for his hypothetical. No previous NSA has contained any language pertaining to post-termination rates, other than those rates in general tariff schedule.<sup>13</sup> Once the contract terminates, Valassis can seek to negotiate a new NSA, with new rates then to be established and subject to Commission review at that time. Or, like any other mailer, Valassis can enter mail under the then-existing general tariff schedule.

Finally, Miller expresses concern that the Postal Service's cost estimate for this NSA may omit administrative expenses, especially if actual volume under the NSA should materialize anywhere near the high estimate submitted by the Postal Service. His concerns on this score also are legitimate, and they mirror similar concerns raised in Valpak's Initial Comments, at 25-26.

## CONCLUSION

Remarkably, this NSA violates not just one, but virtually every element of section 3622(c)(10):

- (i) it will not be available to similarly situated mailers;
- (ii) it violates other policies of Title 39, specifically sections 403(c) and 404a;
- (iii) it neither makes a net contribution to institutional costs nor improves the Postal Service's operations; and
- (iv) it will cause unreasonable harm to the marketplace.

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<sup>13</sup> Miller's appendix is a mathematical exploration of the consequences of his fanciful idea that discounted rates in the contract somehow might supersede the general tariff schedule and be applicable to all of Valassis' mail following contract termination.

Unless the Commission is prepared to reject completely all information presented by a broad swath of the newspaper industry, the NSA cannot be approved.

Although these reply comments address a wide range of issues raised by other commenters, Valpak strongly urges the Commission to begin its analysis with the threshold issue. Valpak believes that the Commission should dismiss the NSA without prejudice for failure to be properly approved by the Governors, since it is therefore not properly before the Commission. *See* Valpak Initial Comments, pp. 3-6. Because the NSA is not properly before it, the Commission should not act upon the NSA on the merits. In view of the substantive comments made by numerous mailers and mailer associations, the Governors should be required to assess this NSA and decide whether they truly want to submit this deeply-flawed NSA to the Commission.

Respectfully submitted,

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William J. Olson  
Herbert W. Titus  
John S. Miles  
Jeremiah L. Morgan  
WILLIAM J. OLSON, P.C.  
370 Maple Avenue West, Suite 4  
Vienna, Virginia 22180-5615  
(703) 356-5070

Counsel for:  
Valpak Direct Marketing Systems, Inc.  
and  
Valpak Dealers' Association, Inc.